

Message Text

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ORIGIN ARA-20

INFO OCT-01 ISO-00 SPC-03 AID-20 EB-11 NSC-10 RSC-01

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COME-00 FRB-02 INR-10 NSAE-00 XMB-07 OPIC-12 LAB-06

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DRAFTED BY ARA/BC-DERBE/RNICHOLSON:BJD

APPROVED BY ARA/BC:JEKARKASHIAN

TREAS:GKOPITS (DRAFT)

LA/DP:LHARRISON (DRAFT)

ARA/ECP:DMORRISSEY (DRAFT)

LA/MRSD:PLANSDALE (DRAFT)

EB/IFD:RGELBARD (INFO)

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TAGS: ECON, EFIN, EAID, CI

SUBJECT; CIAP INTERAGENCY MEETING ON CHILE - DECEMBER 17-18

1. RAUL SAEZ, HEADING CHILEAN DELEGATION, OPENED MEETING WITH DETAILED REVIEW OF ECONOMIC DIFFICULTIES FACED BY NEW GOVERNMENT (A SET OF TABLES USED BY SAEZ IN HIS PRESENTATION BEING POUCHED). HE NOTED THAT PRODUCTION HAD DECLINED SHARPLY IN THE AGRICULTURAL AND INDUSTRIAL SECTORS AND COPPER PRODUCTION HAD INCREASED ONLY SLIGHTLY SINCE 1970. HE SAID THAT MOST OF THE FIRMS TAKEN OVER BY THE ALLENDE GOVERNMENT WOULD BE RETURNED TO THE PRIVATE SECTOR. THE EXPECTED FINANCIAL DEFICIT OF THE PUBLIC SECTOR FIRMS IN
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1973 WILL BE EQUIVALENT IN SIZE TO THE ENTIRE GOVERNMENT BUDGETARY DEFICIT FOR THE YEAR, WHICH IN TURN WILL AMOUNT TO 53 OF GOVERNMENT EXPENDITURES. HE SAID THAT WHILE UNEMPLOYMENT HAD BEEN REDUCED UNDER THE ALLENDE GOVERNMENT

THE MAJOR REASON FOR THIS WAS THE RISE IN UNDEREMPLOYMENT AS REFLECTED BY DECLINING WORKER PRODUCTIVITY SINCE 1970.

2. REGARDING MEASURES TO BE TAKEN BY THE NEW GOVERNMENT, SAEZ SAID THAT THE BUDGETARY DEFICIT WILL BE REDUCED TO 22 OF EXPENDITURES IN 1974. HE SAID ONE OF THE MOST SEVERE MEASURES TAKEN BY THE NEW GOVERNMENT WAS TO DEVALUE THE EXCHANGE RATE BY ABOUT TEN TIMES IN OCTOBER. HE SAID THE GOC INTENDED TO MAINTAIN THE NEW "REAL" RATE THROUGH PERIODIC DEVALUATIONS TO ACCOUNT FOR THE LEVEL OF INFLATION.

HE SAID THE GOC ALSO INTENDED TO LIMIT THE BALANCE OF PAYMENTS DEFICIT TO ABOUT DOLS. 216 MILLION IN 1974. HE SAID THE GOC INTENDED TO CONTINUE THE POLICY OF FREEING PRICES WHICH WAS INITIATED IN OCTOBER, WITH PRICE CONTROLS CONTINUING FOR ONLY A FEW ESSENTIAL COMMODITIES. HE NOTED THE STEADY DECLINE OF REAL WAGES WHICH IN NOVEMBER 1973 AMOUNTED TO ONLY 65 PERCENT OF THE LEVEL IN JANUARY 1970. HE SAID THE GOC INTENDED TO READJUST NOMINAL WAGE LEVELS IN JANUARY 1974 AND NOTED THAT BECAUSE OF THE SURPRISINGLY LOW LEVEL OF INFLATION DURING NOVEMBER 1973 THE LOSS OF REAL WAGES DURING 1973 MIGHT BE REDUCED SOMEWHAT FROM THEIR EARLIER EXPECTATIONS.

3. SAEZ SAID THAT THE ECONOMIC SITUATION WAS SUCH THAT A CONCERTED RECONSTRUCTION EFFORT SUPPORTED BY THE IFI'S WAS REQUIRED. HE STRESSED THE AGRICULTURE SECTOR, NOTING THAT THE NEXT CROP YEAR BEGINS IN APRIL-MAY 1974 (APPARENTLY FOR WINTER WHEAT) AND THAT ASSISTANCE TO FINANCE ESSENTIAL INPUTS WOULD BE NEEDED BEFORE THAT TIME. HE ALSO POINTED TO THE NEED FOR ASSISTANCE IN REFORESTATION AND HOUSING INFRASTRUCTURE AS PRIORITY SECTORS FOR THE ABSORPTION OF LABOR.

4. CONCERNING THE OVERALL ECONOMIC SITUATION HE SAID THAT IT WAS NOT A QUESTION OF STABILIZATION OR LONG-TERM DEVELOPMENT AT THIS TIME BUT RATHER OF RECOVERY TO LIMITED OFFICIAL USE
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PREVIOUS LEVELS WHICH COULD THEN SERVE AS A STARTING POINT FOR FUTURE DEVELOPMENT.

5. IN RESPONSE THE IMF REPRESENTATIVE ANNOUNCED THAT THE FINANCIAL PLAN RECOMMENDED BY THE MISSION TO CHILE HAD BEEN APPROVED BY THE FUND'S MANAGEMENT AND THAT A STABILIZATION CREDIT OF DOLS. 79 MILLION SDR'S (DOLS. 95 MILLION) WOULD BE RECOMMENDED TO THE FUND'S DIRECTORS AT THEIR MEETING ON FEBRUARY 1, 1974. GENERAL SATISFACTION WAS EXPRESSED WITH RESPECT TO GOC POLICY INTENTIONS. THE FUND PROJECTED A DOLS. 95 MILLION BALANCE OF PAYMENTS DEFICIT FOR 1974 ASSUMING SOME DOLS. 115 MILLION IN FOREIGN AID

INFLOWS (IN ADDITION TO THE IMF CREDITS) AND A VERY
LIBERAL RESCHEDULING OF CHILE'S EXTERNAL DEBT.

6. REVIEWING THE GENERAL ECONOMIC SITUATION THE FUND
NOTED THAT WHILE THE FIRST ECONOMIC MEASURES OF THE NEW
GOVERNMENT NECESSARILY HAD RESULTED IN LARGE UPWARD PRICE
ADJUSTMENTS, THERE WERE NOW INDICATIONS THAT THE INFLATION
WAS ABATING MORE RAPIDLY THAN ANTICIPATED. THIS REVERSAL,
HOWEVER, CAME AT THE PRICE OF A SIGNIFICANT REDUCTION OF
REAL INCOME. SOME REBOUND IN REAL WAGES SHOULD NOW BE
PERMITTED TO ASSURE ADEQUATE AGGREGATE DEMAND AS WELL AS
FOR SOCIAL REASONS.

7. THE FUND SINGLED OUT THE AGRICULTURE AND MINING
SECTORS AS KEY TO CONTROLLING INFLATION AND REACTIVATING
THE ECONOMY. REGARDING THE FORMER IMPROVED ORGANIZATION
OF INPUT SUPPLY CHANNELS AND THE RESTORATION OF MARKET
INCENTIVES WERE STRESSED. SATISFACTION WAS EXPRESSED
WITH THE RECOVERY THUS FAR ACHIEVED OF COPPER OUTPUT,
BUT THE FUND ALSO POINTED TO THE NEED FOR A MEDIUM-TERM
INVESTMENT PLAN TO ELIMINATE BOTTLENECKS IN THE SECTOR.
IT NOTED THE IMPORTANCE OF THE GOC'S TAX POLICY BOTH
FROM THE STANDPOINT OF REDUCING THE 1974 BUDGETARY
DEFICIT AND IN TERMS OF ITS SOCIAL IMPLICATIONS. THE
IMF ALSO WELCOMED THE GOC'S ACTIONS TO SIMPLIFY THE EX-
CHANGE STRUCTURE AND ITS INTENTIONS TO MAINTAIN A REAL-
ISTIC EXCHANGE RATE THROUGH PERIODIC SMALL ADJUSTMENTS.

8. DR. SEDWITZ, SPEAKING FOR THE CIAP SECRETARIAT,
CAUTIONED THAT THE LEVEL OF DEMAND AND PARTICULARLY
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PRIVATE CONSUMPTION REQUIRED SPECIAL ANALYSIS AND THAT
ITS GROWTH WOULD DEPEND PARTICULARLY UPON THE QUALITY OF
THE GOC EFFORTS IN THE CONSTRUCTION AND EXPORT SECTORS.
A RATIONALIZATION OF THE FINANCIAL SYSTEM WILL BE NECES-
SARY IF THE HOUSING CONSTRUCTION PROGRAM IS TO BE SUCCESS-
FUL. HE WARNED OF A POSSIBLE INCREASE IN THE LEVEL OF
UNEMPLOYMENT IN 1974, INDICATING THAT A SERIOUS EFFORT
TO SPUR INVESTMENT WOULD BE REQUIRED TO AVERT SUCH A
DEVELOPMENT. HE POINTED OUT THAT FREE MARKET PRICE AD-
JUSTMENTS MAY GIVE OVERINFLATED SIGNALS IN SOME INDUST-
RIES BECAUSE OF LOW PRODUCTIVITY, MONOPOLISTIC ELEMENTS,
AND TARIFF PROTECTION. ALLEVIATION OF THE BALANCE OF
PAYMENTS PROBLEM WOULD DEPEND ON INTERNAL POLICIES, RE-
VITALIZATION OF COPPER OUTPUT, RESTORATION OF INTER-
NATIONAL CREDITWORTHINESS (INCLUDING ACCORD WITH COPPER
COMPANIES), AND FOREIGN AID AND DEBT RESCHEDULING. IN
RESPECT TO EXTERNAL ASSISTANCE, DR. SEDWITZ STATED THAT
MULTILATERAL ASSISTANCE SHOULD NOT BE SUBORDINATED TO
BILATERAL POLITICAL INTEREST AND HOPED THAT THE CHILE'S
INTERNATIONAL CREDITORS WOULD RECONSIDER THEIR CRITERIA

FOR DEBT RESCHEDULING AND BE PREPARED TO AGREE TO GENEROUS TERMS.

9. THE WORLD BANK REPRESENTATIVE SAID THAT AN ECONOMIC MISSION WAS PLANNING TO GO TO CHILE IN FEBRUARY. BECAUSE THE BANK ALSO FELT THAT COPPER WAS KEY TO CHILE'S RECOVERY, TWO EXPERTS WILL VISIT CHILE IN JANUARY TO EXPLORE WAYS OF HELPING TO EXPAND COPPER PRODUCTION. HE ANNOUNCED THAT THE TECHNICAL ASSISTANCE LOAN WAS EXPECTED TO BE APPROVED IN THE NEAR FUTURE AND INDICATED THAT THE IBRD WAS ALSO INTERESTED IN HELPING THE GOC IN THE ECONOMICALLY AND SOCIALLY IMPORTANT AGRICULTURE SECTOR. HE REQUESTED ADDITIONAL INFORMATION FROM THE CHILEANS ON THEIR PLANS AND PRIORITIES FOR MEETING IMPORT REQUIREMENTS AND FOR AGRICULTURAL PRICING.

10. THE IDB DELEGATION REVIEWED THE PROJECTS WHICH THE BANK HAS UNDER CONSIDERATION WHICH COULD HELP ALLEVIATE SEVERAL CRITICAL PROBLEMS. HE MENTIONED LOANS TO FINANCE AN ELECTRIC POWER PLANT AT ANTUCO (DOLS. 65 MILLION), A LIQUID GAS PROJECT (DOLS. 69 MILLION), A DOLS. 20 MILLION LIMITED OFFICIAL USE
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EMERGENCY LINE OF CREDIT TO HELP WITH THE REHABILITATION OF THE AGRICULTURAL SECTOR WHICH WAS UNDER CONSIDERATION, AND TECHNICAL ASSISTANCE IN PROJECT FORMULATION, EVALUATION, AND THE STRENGTHENING OF KEY DEVELOPMENT INSTITUTIONS.

11. THE A.I.D. REPRESENTATIVE STATED THAT WE WERE ENCOURAGED BY THE STEPS TAKEN THUS FAR BY THE GOC AND THE DIRECTION OF THE ECONOMIC POLICIES IT HAD ANNOUNCED FOR THE FUTURE. HE NOTED THAT NEGOTIATIONS ON THE 1972 DEBT WERE UNDERWAY, THAT PREPARATIONS WERE BEING MADE FOR THE UPCOMING PARIS CLUB MEETING IN FEBRUARY, AND THAT THE WRITTEN IMF AND CIAP REPORTS WOULD BE OF PARTICULAR INTEREST IN THIS REGARD.

12. FOLLOWING SAEZ'S RESPONSE TO CERTAIN QUESTIONS RAISED BY THE AGENCIES, THE MEETING CLOSED WITH THE APPROVAL BY ALL PARTIES OF AN AGREED MINUTE. (DRAFT BEING AIR POUCHED.)

13. AFTER SOME DISCUSSION, THE CIAP COUNTRY REVIEW WAS SCHEDULED TO BEGIN ON JANUARY 30 WITH THE EXPECTATION THAT AN APPROVED IMF REPORT AND STAND-BY AGREEMENT WILL BE READY FEBRUARY 1. THE GOC WANTS A TWO-WEEK PERIOD BETWEEN THE CIAP REVIEW AND THE PARIS CLUB MEETING TO CONDUCT BILATERAL DISCUSSIONS WITH THE CREDITORS. PARIS CLUB MEMBERS WILL ATTEND THE CIAP REVIEW AS OBSERVERS.

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